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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of)
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)

RBOC Payphone Coalition Petition for)
Rulemaking To Establish Revised Per-Call)
Payphone Compensation Rate)

RM No. 10568

)
American Public Communications Council)
Request To Update Default Compensation Rate for)
Dial-Around Calls from Payphones)
)

REPLY COMMENTS OF AT&T CORP.

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Reply Comments of AT&T Corp.

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REPLY COMMENTS OF AT&T CORP.

Pursuant to the Commission's Public Notice, DA No. 02-2381, regarding
Petitions for Rulemaking Regarding Payphone Dial-Around Compensation Rate, AT&T Corp.
("AT&T") submits these reply comments in response to the opening comments filed in this
matter. *See* 47 C.F.R. § 1.405.

INTRODUCTION

The comments illustrate both the deep analytical flaws in the petitions of the
RBOC Payphone Coalition ("RBOC Coalition") and the American Public Communications
Council ("APCC") (collectively, "Petitioners") as well as the need for the Commission to initiate
a Notice of Inquiry to assess changes in market conditions and the impact of those changes on
the Commission's approach to payphone compensation.¹

¹ RBOC Payphone Coalition's *Petition For Rulemaking To Establish Revised Per-Call
Payphone Compensation Rate*, Petition for Rulemaking (filed Sept. 4, 2002) ("*RBOC Petition*")
and the American Public Communications Council's *Request to Update Default Compensation
Rate For Dial-Around Calls from Payphones*, Request That The Commission Issue A Notice Of
Reply Comments of AT&T Corp.

November 14, 2002

As shown in Part I, the comments properly highlight that Petitioners' argue, at bottom, that the Commission should authorize a drastic rate *increase* as a means of addressing what Petitioners contend is a *decline* in the demand for payphone services. This proposed "solution" would only exacerbate the problem of declining demand for payphone services by increasing the cost of such services. See AT&T at 6-8. Rather than proceed down this spiral path, the Commission should issue a Notice of Inquiry ("NOI") to address whether and to what extent significant changes have taken place in the payphone market and whether those changes may warrant a different regulatory response to "promote competition among payphone service providers" and "the widespread deployment of payphone services to the benefit of the general public." 47 U.S.C. § 276(b)(1). In this regard, the comments identify numerous areas that an NOI should address, including a full and fair assessment of the reasons for the decline in payphone call volumes, the appropriate level of payphone deployment given the changes in market conditions, including the changes in demand for such services, and the appropriate regulatory response to promote the deployment of payphones "to the benefit of the general public." *Id.*

In all events, as demonstrated in Part II, the petitions should be rejected because there are numerous significant flaws in the methodology and data provided by Petitioners. AT&T at 10-21. The comments confirm that Petitioners have abandoned in significant respects the methodology adopted by the Commission in the *Third Report & Order*.² On the one hand,

Proposed Rulemaking (Or In The Alternative, Petition For Rulemaking) To Update Dial-Around Compensation Rate (original filed on Aug. 29,2002; corrected copy filed Aug. 30,2002) ("APCC Petition").

² *In re Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Third Report & Order, And Order On Reconsideration of the Second Report & Order, 14 FCC Rcd. 2545 (1999) ("*Third Report & Order*").

their data fail to exclude non-working and other sub-marginal, money-losing phones from their calculations of call volume for “marginal” payphone stations. As a result, their call-volume estimates are artificially low. Similarly, Petitioners have inflated their per phone cost estimates by including entire categories of expenses that the Commission already has explained should be excluded from the per-call compensation analysis.

ARGUMENT

I. THE COMMENTS CONFIRM THE NEED FOR A NOTICE OF INQUIRY TO ASSESS THE IMPACT THAT CHANGES IN THE TELECOMMUNICATIONS MARKET HAVE HAD ON THE PAYPHONE INDUSTRY.

Both Petitioners and the commenters observe that the decline in call volume for payphones is largely attributable to the spread of affordable wireless telephony.³ Thus, while the cost of wireless calling plans has continued to fall, *see* AT&T at 6 & n.6, the cost of an unregulated coin call has increased from a range of \$0.25 to \$0.35 several years ago to \$0.50 per call today. *See RBOC Petition* at 2. Petitioners nevertheless argue that the proper way to bolster payphone usage and payphone deployment in the face of increased price competition from wireless technology is to **double** the default compensation rate for payphone dial-around calls. The commenters, however, underscore the economic illogic of promoting payphone use by *increasing* prices and, in doing so, demonstrate that the Commission should issue an NOI to

³ *See RBOC Petition* at 1 (citing “extraordinary decline in the volume of payphone calls due to the proliferation of wireless telephones”); *id.*, attachment at 10 (“As expected, the number of [payphone] stations had decreased from prior years, due largely to wireless penetration and affordability”); *APCC Petition* at 1 (“market conditions have indeed changed substantially since the *Third Report and Order*”); *id.* at 7 (“The dramatic expansion of wireless services has had the effect of reducing the overall volume of calls made at payphones.”); *accord* IDT at 6 (decline in call volumes attributable to “competition from wireless services”); *cf.*, *e.g.*, Sprint at 4 (“Since the payphone services were deregulated, payphones have acquired an often-justified reputation for poor service, poor maintenance, and inflated rates.”); IDT at 11 (discussing survey showing that nearly one-third of payphones in New York City subway stations were broken).

reevaluate its regulatory approach to payphone compensation in light of changing market conditions.

First, as several commenters demonstrate, Petitioners' proposed rate hike would only exacerbate any decline in consumer demand for payphone services. *E.g.*, AT&T at 6-7. As Global Crossing points out, Petitioners "ignore basic economics by wholly failing to take into account demand responses to the proposed increases." Global Crossing at 2,6 (the "normal response" to price competition is to cut prices, not increase them). Put another way, if the price of a payphone call increases, the demand for payphones will decline because consumers will substitute alternatives or simply forego making calls. Indeed, it is low-income consumers with the fewest options, *i.e.*, those who cannot readily switch to wireless telephony, who would bear the brunt of Petitioners' proposed rate increases. *See* IDT at 12. Given these economic realities, the commenters properly observe that Petitioners' proposal would cause the payphone industry to descend into a spiral of declining call volumes and serial rate increases.⁴

Second, although Petitioners argue that their proposal is necessary to stop the decline in payphone deployment, that argument rests on a misreading of 47 U.S.C. § 276(b)(1). *See* AT&T at 7-8. The comments properly explain that Section 276 does not freeze into place an arbitrary minimum number of payphones that must be deployed regardless of changes in market conditions or consumer demand.⁵ Indeed, because Section 276 is designed to "benefit. . . the

⁴ *See* Telstar at 2-3 ("Instead of 'saving' the payphone industry, the proposed increase would likely hasten the payphone 'death spiral' making payphone service even less attractive, resulting in payphone usage further declining and further pricing payphones out of the competitive marketplace."); WorldCom at 3 (proposed rate increase "could accelerate the substitution of wireless calling for payphone use, accelerate usage reductions, [and] accelerate rate increases").

⁵ *See, e.g.*, ATX at 5 ("Obviously, the Commission should view 'widespread deployment' in the context of the changes in technology and in market conditions, as requiring a reasonable level of payphone service so as to actually render a benefit to the public as required in the statutory

general public,” the Commission already has observed “factors, such as the decreasing prices for cellular and PCS service, may reduce the number of payphones,” and that “[s]uch a reduction in the number of payphones would be the result of a competitive marketplace.” *Third Report & Order* ¶ 141 & n. 282. As a result, “[f]ar from being an outcome the Commission feared, . . . the Commission viewed the reduction in payphones due to the growth of competitive alternatives as a legitimate reduction in the number of payphones.” WorldCom at 8-9.

Third, the Commission should initiate an NOI to assess the changes that have occurred in the telecommunications market, the impact that those changes have had on the payphone industry, and the manner in which the Commission can best promote the purposes underlying Section 276. As ATX explains, “To obtain a more accurate picture of the payphone market and to ensure that any modifications to the payphone compensation regime are in keeping with the goals underlying section 276 and in the public interest, Commenters urge the Commission to initiate a Notice of Inquiry . . . before considering any changes in the per-call rate.” ATX at 4.⁶

Specifically, AT&T and other the commenters have identified a number of areas that the Commission should explore through an NOI: (i) the number of payphones removed from service and the reason(s) for their removal, AT&T at 10; (ii) the locations from which payphones have been removed, *id.* at 10; (iii) whether most payphones have been removed principally from locations where there was only one payphone or whether the majority of

language of § 276.”); Telstar at 3 (1998 levels of deployment “may simply not be necessary given the changes in the marketplace and alternate technologies including wireless and paging.”).

⁶ See also IDT at 4 (“If the Commission chooses not to dismiss the petitions outright, . . . it should issue a NOI to examine the status of the payphone industry, dial-around compensation and any changes that should (or should not) be made to the existing methodology.”).

payphones have been removed from locations where there is a bank of multiple payphones, *id.*; IDT at 7-8; Telstar at 4; (iv) the demographic characteristics of the communities from which payphones have been removed, ATX at 6;⁷ (v) how many complaints, if any, have there been about the absence of payphones, WorldCom at 7; (vi) whether payphone revenues would increase if payphone service were improved, IDT at 11; (vii) the manner in which the costs and revenues associated with unregulated payphone services such as Internet access should be addressed, WorldCom at 13; and (viii) the extent of payphone fraud and how an increase in the default compensation rate would affect such fraud, *id.* at 14; ATX at 6-7.

Once the Commission has reached conclusions on these and other questions, it would be in a better position to determine whether its current methodology, or some alternative, such as a caller-pays system, *see* Sprint at 5-7, would best serve the public interest.

II. THE COMMISSION SHOULD REJECT THE PROPOSALS BY THE RBOC COALITION AND APCC BECAUSE THEY ARE BASED UPON ERRONEOUS LEGAL ANALYSES AND UNRELIABLE DATA.

In all events, the Commission should reject the proposals by the RBOC Coalition and APCC to more than double the default payphone compensation rate.

First, the comments highlight that Petitioners base their request for an increase in the default compensation rate on data purporting to show that it now takes dramatically fewer calls to make a phone “marginal” than it did at the time of the *Third Report & Order*. Although neither the RBOC Coalition nor APCC offers any explanation for this development, the

⁷ As WorldCom points out, an article attached to APCC’s petition concludes that payphones have been removed from affluent, not poor, neighborhoods. *See APCC Petition*, attachment 2 at 26 (“Contrary to popular belief. . . [phone companies] are not necessarily removing phones upon which the poor depend. The most profitable phones continue to be in urban and low-income spots, so even when a neighborhood tries to get rid of a phone—as neighborhoods sometimes do, out of concern about drug dealing—the phone company will do everything possible to keep that phone in place, including placating the neighborhood by blocking incoming calls.”).

comments identify several possibilities. First, as shown below, Petitioners' data suffer from significant methodological flaws including that both the RBOC Coalition and APCC improperly have included in their estimates money-losing, submarginal phones (with low call volumes), and that error artificially decreases their estimated per-month call volumes. *See* AT&T at 11-16. Second, Petitioners may be generating other revenue streams, *e.g.*, advertising and Internet services, from their payphone services. *See* Telstar at 5-6; WorldCom at 11-12.

Second, as demonstrated in the comments of AT&T and other parties, the call-volume and cost calculations reflected in the Petitions are based upon flawed data and deviate in significant respects from the methodology adopted by the Commission in the ***Third Report & Order***. *See, e.g.*, AT&T at 10-21. In this regard, the RBOC Coalition inexplicably adopts a new approach to defining the marginal payphone, notwithstanding that the Commission's existing methodology was affirmed by the D.C. Circuit on appeal and was based upon data that the RBOC Coalition previously provided to the Commission. *See id.* at 15-16. As a result, Petitioners arrive at misleadingly low numbers of calls at "marginal" payphones.

Most critically, Petitioners fail to screen out unprofitable stations from the group of "marginal" phones, notwithstanding the Commission's clear requirement that a marginal phone is one that recoups its costs. *See* AT&T at 12-14, 16. As the Commission has made clear, its methodology was "not designed to make every payphone profitable." This flaw in Petitioners' analysis is illustrated starkly by IDT, whose comments underscore the problem of nonworking payphones. IDT at 11. Specifically, IDT cites a survey of payphones in New York City subway stations that found one-third to be nonworking. *Id.* at 11. By definition,

⁸ ***Third Report & Order*** ¶ 79. The Commission went on to explain that "[p]ayphones with sufficiently low call volumes *or* sufficiently high costs will not be profitable, regardless of the compensation amount we establish." *Id.*

nonworking payphones such as these, if included in Petitioners' estimates for "marginal" payphones, improperly would deflate the average number of calls claimed for this group of payphones.' But neither the RBOC Coalition nor APCC has shown that it took steps to eliminate such payphones from the data they used to generate their call-volume estimates.

Finally, Petitioners also inflate their costs by including expense categories that the Commission has already explicitly rejected. *See AT&T* at 14-15, 17-21. For example, the RBOC Coalition includes "bad debt" in its cost calculation, despite the Commission's previous decision, affirmed by the D.C. Circuit, against inclusion of this cost component." As **ATX** explains, the RBOC Coalition's contention that it now has more reliable data does not address the Commission's observation that some of the "bad debt" could be simple billing error or its concern that payphone operators not enjoy double-recovery." Similarly, both the RBOC Coalition and APCC seek to recover "collection costs," even though the Commission rejected these arguments in the *Third Report & Order* on the ground that these costs are already fairly represented in the Sales, General, and Administrative Costs portion of joint and common costs.¹²

⁹ As **AT&T** demonstrated previously, APCC's study suffers from other defects as well. It impermissibly excludes "unpaid" calls from its count (a back-door means of seeking compensation for "bad debt" despite the Commission's exclusion of it from the analysis). *See AT&T* at 14-15. In addition, the study is unreliable because the non-response rate is high and because the participants had a direct economic self-interest in the outcome. *See id.* at 14 n.14; *see also* State of Texas at 3 (noting self-interest problem with APCC survey).

¹⁰ *Third Report & Order* ¶ 162; *American Public Communications Council v. FCC*, 215 F.3d 51, 56 (D.C. Cir. 2000) ("*APCC v. FCC*").

¹¹ **ATX** at 14-15; *see also IDT* at 15 ("[T]here continues to be no evidence that what the payphone providers deem 'bad debt' is anything other than payments withheld due to legitimate billing disputes and billing errors.").

¹² *Third Report & Order* 164; *APCC v. FCC*, 215 F.3d at 57; *see IDT* at 14; **ATX** at 12-14.

CONCLUSION

For these reasons, the Commission should initiate an NOI to assess the impact of changing market conditions on the appropriate methodology for determining the default payphone compensation rate under 47 U.S.C. § 276. In all events, the Commission should reject the modifications to the current default rate proposed by APCC and the RBOC Coalition.

Respectfully submitted,

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Dated: November 14, 2002

Attachment A

Commenters, RM No. 10568

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Global Crossing North America, Inc. (“Global Crossing”)

IDT Corporation (“IDT”)

Sprint Corporation (“Sprint”)

Telstar International, Inc. (“Telstar”)

Office of the Attorney General of the State of Texas (“State of Texas”)

WorldCom, Inc. (“WorldCom”)

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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing Reply Comments of AT&T Corp. was served, by first class mail, unless otherwise noted, the 14th day of November, 2002, on the following:

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